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Australian Securities and Investments Commission (ASIC)
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By email: remediation@asic.gov.au

Dear ASIC,

AFA Submission – CP 335: Consumer Remediation: Update to RG 256

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a code of ethical conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and other than one Independent Director, all Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting their wealth.

Introduction

The AFA fully supports the obligation to remediate a client where they have experienced detriment as a result of poor financial advice. We do not dispute this core premise.

We are concerned, however, in terms of how some of the recent remediation programs have operated, for the following reasons:

- Remediation programs that have extended beyond where there is any evidence of misconduct or non-compliance. We have seen cases where licensees have included a very large number of the clients of advisers who left the licensee five years beforehand, where there is no evidence to suggest any wrongdoing.
- Lack of communication being provided to the impacted financial advisers, who are not

included in the process, however, can often end out being asked to contribute to the cost of the remediation. In many cases, they have not been given an opportunity to challenge the view that the licensee has formed on whether remediation is required.

- The handling of cases where records no longer exist, are incomplete or are not readily available. Where there is no ongoing obligation to retain files, then advisers should not be held accountable. This is compounded by the fact that record keeping requirements and expectations have evolved over time.
- Payments being made to clients without looking to assess whether there are any issues on client files. In these cases, the licensee has chosen to refund fees to all clients below a certain threshold. We fundamentally disagree with this as it immediately sends the message that their adviser must have done something wrong.

As an example, we have recently seen a notice to advisers with respect to a remediation program that covers a period of nearly 10 years, where the licensee has chosen to refund all advice fees without investigation, where the average fee per year is \$500 or less. In this case, they have declined to provide a copy of the list of impacted clients to the adviser, so they do not have the opportunity to contact the client to clarify the matter. CP 335 does not recognise the different roles that licensees and Authorised Representatives play. We would like to see more coverage on the need to provide equitable outcomes for financial advisers.

We are also concerned that these below threshold payments are all feeding into the total amount of remediation that is being publicly reported by ASIC, and there is inadequate context around these arrangements, where the payments are being done to avoid the detailed review of client files, rather than as a result of misconduct.

We are also concerned that RG 256 and CP 335 are excessively drafted in the favour of clients. There are a number of comments such as ‘giving a consumer the benefit of the doubt’, ‘widen the net to capture more consumers rather than less’, and ‘err on the side of overcompensation’. We believe that it is necessary to have a sensible balance in the way these remediation programs are framed.

It is important to note that whereas the large institutions that have been the subject of many of these remediation programs to date, may have the capacity to fund these large open ended and often generous remediation programs, these groups have now largely left financial advice. This concept of ‘deep pockets’ does not apply to the overall advice market and a large remediation program could easily lead to a licensee going into liquidation, which would have a much broader impact on all clients. There needs to be a level of balance in this. The cost of remediation programs for smaller financial advice businesses will ultimately, to some extent, be passed on to clients in the future. These arrangements need to be framed in the context that they could readily apply to small businesses where the impact is more fundamental.

AFA Response to CP 335 Questions

B. When to Initiate a Remediation

B1Q1 Do you agree with our proposed two-tiered approach to initiating remediation? If not, why not?

We are struggling to understand what ASIC is trying to propose in terms of the two-tiered model. It appears that tier 2 is seeking to take these remediation programs to a new level, based upon community expectations. We would not support the extension of remediation requirements beyond what a licensee is legally required to undertake. We are of the view that there is a level of inconsistency between what is suggested in paragraph 25 and paragraph 34. Paragraph 25 seems to imply responding to community expectations, whilst paragraph 34 suggests otherwise.

We are also concerned by the reference to one or more consumers. It is important to separate matters that are dealt with as part of business as usual from remediation programs that should be managed as a project. Confusing the two seems to be inefficient and inappropriate. There is a fixed cost to the establishment of a remediation program, and this should only need to occur when there is sufficient scale to the underlying compliance problem.

C. The Review Period for a Remediation

Review period to start from when a failure first caused loss to a consumer

C1Q1 Do you agree with this proposal? If not, why not?

We are to some extent uncertain as to whether the proposal is that remediation programs should go back beyond seven years or that they should start at the point that the failure first caused loss to a consumer, if that is within the seven years. If there is evidence to indicate that the loss commenced earlier for specific clients, then it may be reasonable to go back further. In our view it should not involve an open ended remediation program going back beyond seven years where there is no specific evidence of wrongdoing. This issue is made more complex by two important factors:

- The record keeping obligations, and
- The fact that AFCA will normally only consider a case where it is less than six years since the loss was first evident.

We are concerned about inconsistency between ASIC's expectation for remediation and AFCA's jurisdiction.

D. Using Beneficial Assumptions

Defining a beneficial assumption and the considerations when using assumptions

D1Q1 Do you agree with our proposal for assumptions to be beneficial and that they should satisfy certain considerations? If not, why not?

As discussed above, we are concerned about the framing of this document in terms of being overwhelmingly in favour of the client. It therefore comes down to the underlying expectations of what a beneficial assumption is and the extent to which this might exceed what would otherwise be described as a fair outcome.

The remediation program needs to deliver an equitable outcome for all parties, including any impacted financial adviser.

D1Q2 Is it appropriate to use assumptions that result in a partial refund for some affected consumers or that involve a discount for a consumer's 'use' of the product? If not, why not?

We are uncertain as to the context of this question and the reference to partial refunds and discounts for use of the product.

D1Q3 Is it appropriate to use an assumption based on an average (e.g. in calculating loss, using the average premium or the average fees charged over a relevant period)? If not, why not?

We are prepared to support the use of averages in a sensible way that should improve the efficiency and the timeframe for the finalisation of remediation and the payment of compensation where

applicable, provided that it is done on the basis of the existence of evidence that the individual client has suffered detriment. Licensees need to find a sensible balance between the cost to undertake a remediation program and the ability to get the outcome entirely precise for each client. This would need to be dealt with on a case by case basis, however we expect that there will be situations where the use of an average delivers a better outcome for all stakeholders.

Using beneficial assumptions to account for absent records

D2Q1 Do you agree with our proposal that beneficial assumptions should be used to make up for absent records? If not, why not?

We are broadly supportive of this proposal in the context that there has been a failure to retain records in breach of legislative or regulatory obligations. Clients should be given the benefit of the doubt in these situations. We do not support this in the context where records have been legally destroyed after the maximum retention timeframe had passed.

When it may be appropriate to use assumptions to increase efficiency

D3Q1 Do you agree with this proposal? If not, why not?

We have been concerned with some of the examples that we have observed of licensees using efficiency to drive outcomes, including the repayment of all ongoing advice fees below a certain threshold.

We are certainly uncomfortable with case study 3. We note the suggestion that Firm V sampled other advisers and was able to identify a cohort of clients that had likely received no service from certain advisers. It is then suggested that instead of reviewing each client book in that cohort to determine whether services had been provided, they would just pay out 100% of the fees plus interest. How was it possible to identify this cohort as likely to involve fees for no services if the client files were not looked at? This does not make sense or at least lacks adequate justification. It seems to imply that they have just guessed and acted on the basis of that guess. There are consequences for such actions that will impact these advisers, and this should not be done on the basis of guess work. We also ask the question as to why these advisers were not given the chance to demonstrate that services had been provided?

D3Q2 In what circumstances do you think it is appropriate to use assumptions to increase the efficiency of a remediation? Please give reasons.

We believe that it is reasonable to use assumptions where there is clear evidence of a failure and that the use of an assumption will lead to an outcome broadly consistent with the outcome that would have arisen if the process had been followed at a detailed level.

E. Calculating Foregone Returns or Interest

Three-step framework for calculating foregone returns or interest

E1Q1 Do you agree with this proposal to set out a three-step framework for calculating returns or interest? If not, why not?

Subject to other feedback that we have already provided, the three step process seems reasonable

We very much question an interest rate of the RBA cash rate plus 6%, when the cash rate is currently 0.1%. This seems to be exceedingly generous in what is a very low interest rate environment.

E1Q3 Should our guidance clarify whether the rate compounds (and at what interval) or whether it should be based on simple interest? Please give reasons.

We agree that guidance should be provided, however we note that there may be circumstances where a simple interest rate calculation is appropriate. The selection of one methodology over the other is likely to also influence the actual benchmark rate that is utilised.

F. How to Approach Finding and Automatically Paying Consumers

Applying best endeavours to find and automatically pay all consumers

F1Q1 Do you agree with our proposal? If not, why not?

We agree that licensees should use their best endeavours to find and automatically pay consumers. There does need to be appropriate recognition of situations where this may not lead to a suitable outcome, and it should not be allowed to drive inefficiency.

F1Q4 Do you agree that cheques should be paid as a last resort? If not, why not?

We agree that cheques should be a last resort as they are an inefficient and problematic way to make payment.

Removing the low-value compensation threshold

F2Q1 Do you agree with our proposal? If not, why not?

We support the retention of a low-value compensation threshold, as there is inevitably a point at which the remediation amount is so low that it is inefficient and potentially inappropriate to make the payment. There will be certain cases where such a payment might be treated as taxable, and therefore this will only cause complications for the client.

F2Q2 Do you think that any licensee using a low-value compensation threshold should have to disclose it? If not, why not?

It is unclear how they would disclose this and who they would need to disclose it to. Nonetheless, as a high level principle, we would support disclosure of such arrangements.

G. Remediation Money that Cannot be Returned to Consumers

Clarifying our guidance for remediation money that cannot be returned

G1Q1 Do you agree with our proposal? If not, why not?

We support a model where these residual funds are paid to a charity, that is a designated gift recipient (DGR), at the choice of the licensee. We do not believe that it should be extended to a community organisation that is not a DGR, or at the direction of ASIC.

G1Q4 Do you think any licensee making a residual remediation payment to a charity or not-for-profit organisation should have to clearly disclose it? If not, why not?

We are unsure how it is suggested that this disclosure should happen, however we are supportive of the existence of sensible disclosure requirements.

H. Settlement deeds

Settlement deeds and fair consumer outcomes

H1Q1 In what circumstances, if any, are settlement deeds essential to protect your legitimate interests? Please provide examples or other supporting evidence.

We support the use of settlement deeds where there is a genuine risk of the client subsequently seeking further compensation for the same issue. This is much less likely to be a factor when a unit pricing error occurs or a fee has been incorrectly charged, however in the case of a claim of inappropriate advice, it would be appropriate where the offer of compensation is a full and final offer. As such, this is likely to arise in the context where there is a level of judgement in the assessment of the wrongdoing, rather than a matter where the calculation is straight forward and not subject to any dispute.

Concluding Comments

The AFA supports a model of fair and equitable remediation for clients who suffer detriment as a result of wrongdoing or non-compliant conduct by a financial service provider. It is our view that these remediation programs need to be sensibly managed and that payments of compensation should be based upon evidence of wrongdoing. We are quite concerned about how some of the recent remediation programs in the financial advice sector have operated in recent years, where compensation has been paid where there is no evidence of failure. We are also concerned about how financial advisers have been treated as part of these processes, whether through being excluded from the consideration of the matter or subject to remediation decisions that will have an ongoing impact on their relationship with their clients. They have also, in many cases, been required to make payments to the licensee as part of the remediation, despite not having any ability to assist in the provision of information to support their position.

The AFA welcomes further consultation with ASIC should clarification of anything in this submission be required. Please contact us on .

Yours sincerely,

General Manager Policy and Professionalism
Association of Financial Advisers Ltd